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# REPORT OF

# THE MINISTERS COMMITTEE

# ON

# LIABILITY INSURANCE

January 30, 1987

Honourable Neil Crawford
Minister of Municipal Affairs
227 Legislature Building
Edmonton, Alberta
T5K 2B6

Honourable Sir:

I have the honor to present herewith, the report of your Committee on Liability Insurance.

The report consists of three sections:

The first section could be classified as the principal report containing the issues, the committee's approach, conclusions and recommendations.

The second section consists of a report prepared for the committee by ANISTICS INC., of San Francisco. Anistics Inc. was tasked to examine the feasibility of self insuring a portion of the general liability risk through a risk pool, or pools. Their report concludes this is feasible.

The third section is a report prepared by Reed Stenhouse Limited of Edmonton to provide the Committee with information relating to the feasibility of the establishment and operation of a pooling system, or systems to cover a portion of the liability risks of local government units. This section relates specifically to the implementation of recommendations No. 1 and 3.

The committee, with the aid of the supporting reports has been able to make the recommendations with full confidence that their implementation is desirable, practical and economically feasible for both the province and the local authorities.

These reports provide evidence to substantiate the validity of the recommendations. In addition it should be noted that all the recommendations were approved by a large majority at the annual conventions of each association in the fall of 1986.

The Committee members feel it is an essential element of this task to meet with you and any of your cabinet colleagues who have a concern with this subject following your review of the report. The purpose of this meeting would be to allow for a discussion of concerns and solutions as well as providing explanations where these seem warranted.

The representatives of the Local Government Associations (AAMD&C, AUMA and ASTA) are particularly concerned that they have an opportunity to expand upon and strengthen their expression of concern, particularly on recommendations 2, 4, and 10.

Respectfully submitted on behalf of the committee.

J. M. Fleming,
Chairman

NOTE:

Shortly after the Ministers Committee was established the Provincial Treasurer engaged the services of Mr. Jim Wilkin, a retired insurance executive of international renown. He was given the task of providing advice and assistance to government agencies and the private sector who were encountering problems in obtaining suitable liability insurance coverage.

The Committee sought his advice on how the study might best be conducted and who might be able to provide the type of expertise necessary to complete the assigned task.

Mr. Wilkin offered to provide a team of experts to act as advisors to the Committee and was in fact able to co-opt two senior executives of Reed Stenhouse Ltd. to act as advisors to the Committee without charge.

The Committee acknowledges with thanks the outstanding contribution of Mr. Grant Duncan and Mr. Tony Wadsworth.

The following recommendations and comments result from an overall determination of the feasibility of self insuring portions of local government risks. This determination is provided by the "Anistics Inc. Feasibility Study". The assessment of results likely to be obtained by formation of a Reciprocal Insurance Exchange operated to insure the local Government layer of risk between $2,000,000 and $7,000,000 is demonstrated by the Reed Stenhouse report. This report deals with a Reciprocal Insurance Exchange or Exchanges operated in combined form and on an individual basis for each association (AAMD&C, AUMA and ASTA).

The benefits of a combined form are very evident in the combined pro forma financial statements of this report.

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# INTRODUCTION

One of the most dramatic factors to affect local authorities in recent years has been changes in liability insurance. In the United States, Canada and more particularly in Alberta, which is the focus of this report, premium rates have skyrocketed. Deductible levels have increased and in some cases coverage of some risks has become unavailable. Although the effects of these changes did not occur first in Alberta, the effects have now become widely felt and apparent in all areas of the province.

The cause of this problem is not specifically identifiable, however, it has been variously attributed to the courts, the legal profession, the insurance industry, the general public, terrorism and the economy. All of these must bear a portion of the blame but whom to specifically blame for this set of circumstances is not at issue here.

The results of these developments are that:

1. few insurance companies are prepared to provide broad liability coverage to local authorities.

2. buyers of insurance have almost without exception found, that despite favourable paid loss experience, premiums to be inordinately high when compared to the premium of the previous year.

Attitudes of Courts and awards made reflect an unduly generous approach toward plaintiffs.

The fact that the previous years' premium was too low or that the coverage offered for that premium was too wide, did not have mitigating effects on the concerns felt in the offices of local authorities. The strong feeling expressed by the local authorities likewise did not have a moderating effect on the premium increases requested or the narrowing of coverage. The narrowing of coverage included the total unavailability of environmental impairment coverage.

The foregoing conditions, coupled with the risk of "going bare" in 1986-87, indicated to the Minister of Municipal Affairs that this serious situation must be dealt with on behalf of the local authorities and in cooperation with them. The Minister of Municipal Affairs therefore established this committee to address the concerns and submit recommendations for consideration and action. The committee, established by the Minister of Municipal Affairs in March of 1986, consists of:

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| Alberta Association of Municipal Districts & Counties | 2 members |
| Alberta Urban Municipalities Association | 2 members |
| Alberta School Trustees Association | 2 members |
| Representation of the cities which do not participate in the insurance programs of the municipal associations | 1 member |
| Alberta Treasury | 1 member |
| Alberta Consumer and Corporate Affairs | 1 member |
| Alberta Education | 1 member |
| Alberta Municipal Affairs | 2 members (1 of whom will be chairman) |

# TERMS OF REFERENCE

## Study Objectives

In broad terms the committee was charged with the following objectives:

1. To study the problems and future trends faced by Alberta Municipalities and School Authorities hereinafter referred to as Local Authorities in purchasing adequate and suitable insurance coverage;
2. To analyse and quantify the liability risks, including environmental risks confronting Alberta municipalities and school authorities;
3. To review current legislation and possible need for changes in legislation;
4. To study alternative methods of providing adequate and effective coverage by means other than insurance programs; and
5. To make recommendations which will resolve the liability insurance problem in the most cost effective manner on a long term basis.

## Timing

Due to the perceived urgency of the situation it was suggested that the study be completed as soon as possible, having regard to a realistic time frame for the study without substantial cost additions.

## COMMITTEE APPROACH

As a result of committee deliberations, interviews with insurance executives and consultants, the committee took into consideration both the long and short-term issues of:

1. providing a workable solution to current insurance availability problems,

2. providing cost effective protection against loss due to liability, for local government units and

3. proposing legislative amendments to moderate or structure Court awards.

## THE CURRENT SITUATION

Local authorities provide services within their individual localities based on perceived needs and in keeping with their ability and budgetary resources. They are also called upon to provide service programs on behalf of the province and for which they receive conditional transfers. As a result, local authorities are vulnerable because they engage in these activities that expose them to liability for accidents or experience for which liability insurance coverage is necessary.

Examples of these activities may include:

- parks and recreation programs
- public works (roads)
- education and associated activities
- inspection and regulatory control
- agricultural services programs
- social services.

While local authorities operate in partnership with the Provincial Government they do operate independently of the Provincial Government with regard to insurance. In this partnership the local government units bear the costs of protection against liability and ultimately against loss. Although the delivery system is mutually acceptable to both parties with the Provincial Government providing funding on a predetermined basis the process does not contemplate the effects of these funds on the liability exposures of local authorities.

The exposure of local authorities on liability insurance claims is perceived from two differing viewpoints:

1. The insurance industry views the exposure of local authorities as anything but good and cites as examples unattended potholes in streets, warning signs knocked down and not replaced, excavations not fenced, stop signs obscured, poor maintenance of public buildings, careless operation of machinery and motor vehicles.

2. The view of local authorities is that they do a good job but can't oversee everything every day. Alberta local authorities are however, placing increased emphasis on loss prevention programs on a province wide basis.

Many participants in the Alberta local authorities insurance market have placed their insurance requirements for the 1986-87 year with premium increases of less than those experienced for the 1985-86 year, although these premiums may be for less coverage. The high rate of premium increases which were experienced in 1985 are now showing signs of moderating. The current moderation of rate increases does not guarantee an end to wildly fluctuating premium costs but rather may indicate the beginning of a moderate cycle.

Over the past two years premium rate increases have ranged from 150% to 1000% (a ten fold increase in some instances). These increases have been coupled with restrictions of items for which the policy would provide protection. While rate increases are seen to be moderating the overall cost of protection remains inordinately high.

In normal circumstances, it is generally agreed that premium rate increases and the extent of availability of insurance coverage cycle on a seven year basis. While this can be said to be true for the last forty or fifty years, it is evident that these cycling periods are now becoming longer in duration (and therefore more violent on each occasion and thus their effects are viewed with more and more alarm) and a review of the insurance industry claims experience shows this to be the case. The downturn in the current situation can be said to be twice as severe as the previous downturn in the mid-70s which, itself, can be seen to be twice as severe as the previous downturn in the late 1960s. The concern is that the downturn in the 1990s may be catastrophic.

# CONCLUSIONS

The Committee concludes that: -

- legislative amendments are, in fact, necessary and

- a pooling system is the only means available to remove the detrimental effects of the fluctuations in cost and coverage which have been imposed upon local authorities in recent years in the liability insurance area.

The peaks and troughs associated with the insurance cycle have now become so extreme that local authorities cannot reasonably be expected to continue delivering their established level of services without introducing a level of stability which the recommendations of this report have contemplated.

The committee concurs that the recommendations of this report will result in a cost effective system of liability protection for local governments thereby benefiting all Albertans. The Committee strongly urges the Government of Alberta to recognize the severity of these concerns and to commit its support on a long term basis, as outlined in the recommendations. This commitment is necessary to establish and facilitate the growth and stability of the pools which will provide local authorities with the loss protection required.

The report contains interrelated recommendations which should be viewed as a package each dependent on the other and therefore not separable.

## RECOMMENDATION NO. 1

That Alberta local authorities, through their respective associations (Alberta Association of Municipal Districts and Counties, the Alberta Urban Municipalities Association, and the Alberta School Trustees Association) enter into a pooling agreement for some liability coverage and that this pooled protection initially be provided on annual aggregated losses of $5,000,000 in excess of $2,000,000.

The effect of this recommendation therefore, would be to provide coverage for losses in excess of $2,000,000 but only to a maximum payment from the fund of $5,000,000 in any year. The management group directing this protection program would be mandated to purchase necessary additional coverage for the overall protection of their client members.

The choice of the insurance layer between $2,000,000 and $7,000,000 was made as a direct result of the ANISTICS Self Insurance Feasibility Study and discussions with insurance industry representatives. The data base provided for this study did not include the cities of Calgary and Edmonton. (both municipalities and schools) Two considerations brought about the selection of the $2,000,000 to $7,000,000 layer for the initial thrust into group protection:

1. The ANISTICS study substantiated that this $5,000,000 layer is overpriced and therefore the premium charged for the protection provided is excessive.

2. By continuing to purchase conventional insurance for the first $2,000,000 of coverage the group will also receive benefit of:

claims adjusting;
defense costs;
legal and accounting; and
staff

all of which are included in premium charges and would reduce the need for the participants to hire these services. In addition to the foregoing this initial layer of protection is at present moderately priced and provides good value.

It is implicit in the foregoing recommendation that the local government units involved will continue, for the present, with the purchase of conventional primary coverage with a limit of $2,000,000. The local authorities will also continue to purchase their coverage in excess of $7,000,000.

RECOMMENDATION NO. 2

That the Government of Alberta provide a guarantee of financial support on a declining basis for losses in excess of $2,000,000 which may be chargeable against the pool created in Recommendation No. 1 and this guarantee remain in force until the fund is self-sustaining.

It is essential that there be an assured source of funding available to cover losses which may become payable. Such a guarantee will ensure the viability of the pool until sufficient reserves have accumulated to make it fully self sustaining.

## RECOMMENDATION NO. 3

That Alberta local authorities through their respective associations (the Alberta Association of Municipal Districts and Counties, the Alberta Urban Municipalities Association and the Alberta School Trustees Association) establish a special pool with a minimum funding level of $10,000,000 to provide protection against uninsurable risks.

There are many exposures akin to the operation of local authorities where conventional insurers have either eliminated or reduced the capability of a Local Authority to secure adequate insurance protection and these include the following:

a) Medical Professional Services

b) Segregation, Education, Supervision

c) Sexual Abuse, Molestation, Etc.

d) Injury to Participants (sporting activities)

e) Pension Trust/Employee Benefit Liability

f) Dependents (loss of companionship, etc.)

g) Premises used for Winter Sports

h) Existence of any Condition in Water

i) Land Movement

j) Downstream Flooding

k) Asbestos Liability

l) Police Liabilities

m) Building Inspection

n) Environmental Impairment

o) Aerial Spraying

p) Flooding

q) L.R.T. risks

## RECOMMENDATION NO. 4

That the Government of Alberta provide a guarantee of financial support on a declining basis for losses which may be chargeable against the special pool until the pool becomes self-sustaining.

The intent of this recommendation is to preserve the viability and the special pool and its operation by requesting that the Provincial Government provide financial support for losses which may be incurred and which are in excess of the pool balance at the time of the loss. This special pool is expected to be self-sustaining in approximately 10 years barring catastrophic losses. This period of stabilization would vary if the Cities of Edmonton and Calgary were to participate.

## RECOMMENDATION NO. 5

That an annual charge be levied against each local authority participating in the pool(s).

The foregoing annual charge would be used to determine the overall amount of the annual total contribution to the pool(s). The levy against each participating authority would be determined independently on a basis mutually agreed to by the participant(s).

In the case of a special pool the advice received by the committee indicates that this special pool should be targeted initially to reach $10,000,000 and should likely be increased thereafter in accordance with further advice and consideration of the risks being, or to be, covered.

The intention of this annual charge would be to ensure that the fund will have an annual inflow of funds for growth purposes.

For example if all municipalities and school authorities in the province participate on a per capita basis the funding provided in 1986 would be:

| | |
|---|---|
| Alberta Population @ $1 | = $2,354,131 |
| Alberta School Population @ $1 | = 435,000 |
| | $2,789,131 |

If Calgary and Edmonton (cities and school authorities) did not participate this figure would be reduced to approximately $1,280,000.

It is not the intention of the committee to specify the annual charge but rather to use this as the basis of determining the overall annual funding and then to assess on an actuarial basis the costs attributable, by premium charge, to all participating local authorities.

This funding practice would continue until the management of the pool finds it necessary to make adjustments to the annual levy.

RECOMMENDATION NO. 6

That local authorities continue to be responsible for providing coverage for their physical assets.

This recommendation is intended to clearly indicate that the continuation of conventional coverage will be required for the protection of assets which will be the responsibility of the local authority.

## RECOMMENDATION NO. 7

That the local authorities choosing to participate in either or both pool(s) of the program be required to make a long-term commitment to the pooled protection system.

Group self-insurance or pooling cannot be viewed as a short-term solution because a pooling scheme can only succeed if the participants are committed on the long-term basis. It would be desirable if under the scheme being proposed here, each participant was committed for a minimum 5 year period with a 2 year notice to opt out. This requirement would add stability to the fund, provide an assurance of revenue for the first 5 year period, and would permit reasoned actuarial planning to begin.

## RECOMMENDATION NO. 8

That in adopting the pooled protection options outlined, and recommended, in this report, "The Reciprocal Insurance Exchange" method of funding be considered.

The Reciprocal Insurance Exchange concept requires that a group have similar activities and interests. This similarity in activity then indicates a similarity of risk and exposure to be present in the group.

The group then contracts with each other to spread the risk and losses which will likely result from their activities.

The costs which each participating member of the group must bear (premiums) is, of course, based on an assessment of their past experience of losses and a forecast of their future potential for losses.

Reciprocals do not require huge amounts of capital but are rather based on the mutual agreement of members to contribute to the losses incurred by other members. This comment does not preclude the need for establishing, in advance of loss, some build up of funds to meet certain of the claims chargeable against the reciprocal, but only limits the size of these reserves to some extent.

Some advantages of a Reciprocal Insurance Exchange are as follows:

- requires no legislative amendment to permit establishment,
- the Alberta Superintendent of Insurance has agreed with the principle of this protection method for this particular group,

- a program of reciprocal protection can very quickly be put into operation once approval is received,

- there are no initial capital and surplus requirement for a Reciprocal Insurance Exchange which must be met prior to a formal start up of activity,

- a Reciprocal Insurance Exchange system can, in periods of low premium, protect their members by purchase of all or a portion of their needs, and

- stability of costs on an annual basis improves with the term of existence of the program.

As with any proposal there are some disadvantages, some of which are listed:

- participants must be committed to long term participation (likely 5 years) as opting in and out tends to reduce the stability of the overall program,

- in some circumstances conventional protection against certain risks may be more economically available in the short-term,

- it may be necessary in the start up period to assess members for not only the cost of protection but also for start up costs, and

- to obtain authority of the Superintendent of Insurance for Alberta to begin operations may require extensive documentation and approval time.

RECOMMENDATION NO. 9

That proposals for establishing and managing the pool(s) be called for, following general agreement that pooled loss protection in some form is a desirable course of action by

- the Alberta Goverment
- the associations which are, at present, delivering the insurance package to their members (AUMA, AAMD&C, ASTA) and the local authorities, at their 1986 conventions.

## RECOMMENDATION NO. 10

That the Government of Alberta enact legislative changes to clarify the risks and to reduce the claims costs facing local authorities.

Some areas suggested for change are:

1. That the rules of Joint and Several Liability be amended in the statutes to reflect responsibility of a defendant only to the percentage in dollar terms to which he has been judged responsible.

2. That legislation be enacted to restrict the liability of municipal and school directors and officers with respect to the performance of his or her duties.

3. That legislation be enacted which would limit the use of contingency fees and contingency agreements for legal services.

4. That legislation be enacted to make mandatory, structured settlements in cases of Court awarded personal injury awards which exceed $250,000. This requirement would not be imposed if both plaintiff and defendant agree to a lump sum settlement.

5. That legislation and court practice be amended to require a division of trials with the matter of liability being determined at the first trial.

6. That the rules governing prejudgement interest be changed so that this interest is granted only after the defendent's lawyer has been provided with sufficient information to properly assess the question of liability.

7. That legislation when enacted consider the experience of other jurisdictions with regard to considering a program of liability capping or limiting for Alberta local authorities.

8. That legislation be enacted which would exempt local authorities from paying premium tax on insurance business transacted through their reciprocal insurance exchanges.

9. That the province negotiate with the federal government to eliminate the payment of tax for settlement of personal injury claims when in the hands of the recipient.

# SUMMARY OF RECOMMENDATIONS

RECOMMENDATION NO. 1

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RECOMMENDATION NO. 2

That the Government of Alberta provide a guarantee of financial support on a declining basis for losses in excess of $2,000,000 which may be chargeable against the pool created in Recommendation No. 1 and this guarantee remain in force until the fund is self-sustaining.

RECOMMENDATION NO. 3

That Alberta local authorities through their respective associations (the Alberta Association of Municipal Districts and Counties, the Alberta Urban Municipalities Association and the Alberta School Trustees Association) establish a special pool with a minimum funding level of $10,000,000 to provide protection against uninsurable risks.

RECOMMENDATION NO. 4

That the Government of Alberta provide a guarantee of financial support on a declining basis for losses which may be chargeable against the special pool until the pool becomes self-sustaining.

RECOMMENDATION NO. 5

That an annual charge be levied against each local authority participating in the pool(s).

RECOMMENDATION NO. 6

That local authorities continue to be responsible for providing coverage for their physical assets.

RECOMMENDATION NO. 7

That the local authorities choosing to participate in either or both pool(s) of the program be required to make a long-term commitment to the pooled protection system.

RECOMMENDATION NO. 8

That in adopting the pooled protection options outlined, and recommended, in this report, "The Reciprocal Insurance Exchange" method of funding be considered.

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